Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Coto	Analyst:	William Koch	Bill Number:	AB 2372
Related Bills:	See Legislative History	Telephone:	845-4372	Introduced Date:	February 21, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: College Affordability Act Of 2008-Impose Additional 1% Tax On Taxable Income In Excess Of $1Million

SUMMARY

This bill would do the following:

- Impose an additional 1% tax on the taxable income of taxpayers subject to tax under the Personal Income Tax Law (PITL) that exceeds $1 million.
- Create the College Affordability Fund within the State Treasury.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to prevent college from becoming less affordable for California's children by freezing college tuition and fees at the California State University and the University of California for five years.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current state and federal laws impose six different income tax rates on individuals ranging from 1% to 9.3% and 10% to 35%, respectively. Each tax rate applies to a different range of taxable income known as a "tax bracket." Existing state law requires the FTB to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

For taxable years beginning on or after January 1, 2005, California law imposes an additional 1% Mental Health Tax (MHT), not subject to reduction by credits, on the portion of taxable income that exceeds $1 million for taxpayers subject to tax under PITL. The taxable income threshold of $1 million is not indexed based on changes in the CCPI.

Board Position:			Department Director	Date
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The MHT is subject to estimated tax payment requirements, interest, penalty, and other tax administration rules because it is treated the same as the personal income tax imposed under existing law.[1]

THIS BILL

For taxable years beginning on or after January 1, 2009, this bill would impose an additional 1% tax on taxable income in excess of $1 million for taxpayers subject to tax under PITL. This tax, combined with the existing MHT, would effectively create an 11.3% tax bracket for individuals, estates, and trusts with taxable income in excess of $1 million.

The additional tax imposed by this bill would not be reduced by tax credits or be subject to estimated tax payment requirements because it would not be considered a tax imposed by Revenue &Taxation Code (R&TC) section 17041. In addition, the $1 million threshold for imposition of the tax would not be annually indexed based on changes in the CCPI.

This bill would also establish the College Affordability Fund within the State Treasury. The revenue from the additional tax imposed by this bill would be continuously appropriated to the California State University and the University of California to offset increased costs of educating resident undergraduate students, as specified.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill fails to specify a transfer schedule or funding mechanism to address how and when the revenue generated from this additional tax would be identified and transferred from the state's General Fund to the College Affordability Fund. Without clear direction, identifying the amount of revenue attributable to the additional tax imposed by this bill and the timing of transfers of the revenue to the College Affordability Fund could be problematic and costly. To facilitate FTB's administration of this bill, the author may wish to consider the provisions of R&TC section 19602.5, enacted as a result of Proposition 63, which provides estimates of revenue and a detailed calculation and transfer rate of the MHT.

In addition, administrative uncertainties exist because the additional tax imposed by this bill would not be treated as if it is a tax imposed under R&TC section 17041. The author may wish to consider adding language that would treat the additional tax imposed by this bill as a tax imposed under R&TC section 17041.

[1] Revenue and Taxation Code sections 17041 and 17043

LEGISLATIVE HISTORY

AB 2897 (Hancock, 2008) would increase the top personal income tax rates to 10% and 11% and increase the alternative minimum tax rate to 8.5%. The language in AB 2897 does not identify how the additional tax imposed would be used. This bill is currently in the Assembly Revenue and Taxation Committee.

Proposition 82 would have imposed an additional 1.7% tax on taxable income in excess of specified threshold amounts. The additional revenue would have been used to provide funding for preschool programs. This initiative failed to pass during the June, 2006, Primary.

AB 1177 (Chan, 2006) would have raised the maximum personal income tax rates to 10% and 11%. The additional revenue would have been used to provide funding for K-12 education and community colleges. This bill failed to pass out of the Senate Revenue and Taxation Committee by the constitutional deadline.

AB 6 (Chan, 2005), AB 4 (Chan, 2003), and SB 1255 (Burton, 2002) contained language similar to the language of AB 1177. All three of these bills failed to pass out of their house of origin by the constitutional deadline.

ACA 24 (Cohn, 2005) would have imposed an additional tax at the rate of 1/40th of 1% on taxable income in excess of $1 million to fund domestic violence shelter services. This constitutional amendment failed to pass out of the house of origin by the constitutional deadline.

Proposition 63 (Steinberg), approved by voters during the November 2, 2004, General Election, enacted the 1% tax on taxable income in excess of $1 million to provide dedicated funding sources for the expansion of mental health treatment options for children, adults, and seniors.

OTHER STATES' INFORMATION

Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not impose a college affordability tax similar to the additional tax imposed by this bill. The current maximum personal income tax rates for *Illinois, Massachusetts, Michigan, Minnesota* and *New York* are 3%, 5.3%, 3.9%, 7.85%, and 6.85%, respectively. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until the implementation concerns have been resolved, but are anticipated to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed within this document, this proposal would result in the following revenue gains.

Estimated Revenue Impact of AB 2372 Effective for Tax Years Beginning on or After 1/1/09 Assumed Enactment Date After 6/30/08 ($ in Millions)			
	2008-09	2009-10	2010-11
General Fund	$600	$1,700	$1,800
College Affordability Fund Transfer			($800)
Net Impact to General Fund	$600	$1,700	$1,000
Behavioral Impact to the Mental Health Services Fund	$5	($50)	($40)

This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill is dependent on the amount of taxable income reported by taxpayers subject to tax under PITL that exceeds $1 million. This estimate assumes that the tax would be imposed on each tax return, regardless of filing status.

The MHT generated $1.34 billion for tax year 2006. The result of growing the 2006 tax year revenue by Department of Finance projections is increased revenue of $1.65 billion for tax year 2009. Because this bill does not limit the new 1% tax to timely filed returns, the estimate is increased by 3%. It is assumed that these funds would be collected over a three-year period because this revenue would relate to the filing of amended returns and audit assessments. To account for this adjustment, the 2009 taxable year estimate is increased by 1% to $1.66 billion (1% = 1/3 of 3% adjustment).

To the extent possible, taxpayers are anticipated to alter their behavior by changing their tax planning strategies. It is anticipated that some taxpayers may delay transactions that would generate capital gain income, alter their current level of compliance, or change their business filing status from a sole proprietorship to a corporation to benefit from the lower corporate tax rate. Based on an analysis of tax return data and relevant economics literature, it is estimated that these behavioral impacts would reduce the estimate for tax year 2009 by approximately 10% to approximately $1.5 billion ($1.66 billion x 90%). It is also anticipated that some taxpayers may respond in anticipation to the new law and accelerate capital gain transactions, and thus realize income during 2008 that otherwise would have been realized during 2009. This behavioral response shifts 10% or $150 million from tax year 2009 to 2008. After making these adjustments, the impact for tax year 2009 is estimated to total approximately $1.3 billion ($1.5 billion x .90).

The overall reduction of income that results from behavioral changes by these high-income taxpayers would result in annual revenue reductions to the Mental Health Services Fund beginning with fiscal year 2009/10.

The estimate in the chart has been adjusted to reflect the cash flow impact. The impact for fiscal year 2008/09 includes revenue accelerated from taxable year 2009 and anticipated changes in estimated tax payments.

The bill does not specify when revenue would be transferred to the College Affordability Fund. Therefore, it is assumed that the transfer would be made in January 2011, three months after the 2009 tax year extension filing date, when data on the amount of tax assessed is available.

POLICY CONCERNS

Taxpayers subject to tax under the PITL who have taxable income in excess of $1 million are currently subject to the 1% MHT. The provisions of this bill would subject the same income to an additional 1% college affordability tax.

Funding based on additional taxes imposed on high income taxpayers creates uncertainty because the amount of income reported by high income taxpayers is volatile.

LEGISLATIVE STAFF CONTACT

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